Backgrounder

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THE GOODS AND SERVICES TAX: PROVINCIAL PERSPECTIVE

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INTRODUCTION

Reforming taxes on consumption is always difficult in a federal political system, for the same taxation system is generally used at more than one level of government. Of the countries with federal constitutions, only Austria and West Germany have a multi-stage tax on consumption. Australia, Canada, Switzerland and the United States tax consumption at the manufacturing, wholesale or retail sales level. Canada is the only country now trying to introduce a value-added tax (VAT) at the federal level, parallel to the provincial sales taxes already in place.(1)

On 24 April 1989, Finance Minister Michael Wilson announced that the federal government would introduce on its own a goods and services tax (GST), a multi-stage sales tax on value added. Negotiations with the provincial governments on a national sales tax (NST), a tax to consist of a standard federal rate and variable provincial rates applied to a common base, were broken off until further notice. The federal authorities maintained the provinces did not realize the urgent need for this measure, but the Minister did not dismiss the idea of future provincial participation.

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(1) A similar situation could develop in the United States if its administration were to consider introducing a federal VAT. This was discussed in the mid-eighties. Several academics and politicians then suggested VAT as a means of solving budgetary problems, but the Reagan administration rejected the idea because of the regressivity of the tax, the risk of inflation and the danger that the increased revenue would encourage a growth in bureaucracy.

Ontario Treasurer Robert Nixon stated that he was not greatly upset by Ottawa's unilateral decision, while his British Columbia counterpart, Mel Couvelier, approved of the move, saying Ottawa was showing a sense of responsibility towards the growing budgetary problems. Such comments may seem surprising. Still, as many expected, the provinces objected to the tax plan once they learned its details. The day after their meeting in Quebec on 21 and 22 August 1989, the provincial premiers announced their opposition to the tax and asked their officials to assess its potential economic effects and to prepare reports to be made public in November 1989.

The sectoral impacts of the proposed tax would be felt differently in the different provinces. We know, for example, that those with less capital-intensive industries or those that export less than the others would have little to gain in terms of efficiency, and that those which consume more services would lose the progressivity in their tax system. Microeconomic and macroeconomic effects would vary from province to province, and consequently so would complaints.

Some provinces will oppose the federal proposal not only on the grounds of the tax's economic effects but also by claiming that it would be unconstitutional, would reduce their political room to manoeuvre and would adversely affect their own tax system. This paper examines the constitutional, political and fiscal concerns that the proposed tax raises for the provinces that collect retail sales tax. As will be seen, some of the arguments they will try to use are invalid, while others remain to be proved.

CONSTITUTIONAL ARGUMENTS

A. Division of Taxation Powers

The taxation powers of the two levels of government are defined in subsections 91(3), 92(2) and 92(9) and sections 121, 122, 123, 124 and 125 of the <u>Constitution Act, 1867</u> (see appendix). The authors of the Constitution distinguished between direct and indirect taxation,

following John Stuart Mill, who defined the first as tax collected from the same person who pays it and the second as tax collected from a person who will recover it from another person.(2) At the time, government sources of revenue were confined to three taxes: customs, excise and property tax. Subsections 92(2) and 92(9) and section 121 were designed to limit provinces to direct taxation, specifically property tax, while the federal government kept indirect taxation, that is, excise taxes and customs duties.

The authorities collected other forms of tax as temporary sources of revenue in emergencies. The 1914 to 1918 war effort created such financial needs that the federal authorities had to introduce tax on corporations (1916), personal income tax (1917) and the present federal sales tax (1924). These three new forms of taxation were supposed to be temporary, but the depression of the 1930s shelved the government intentions in this regard. The Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois Commission), appointed in 1937, was given the mandate to study Canada's tax system and assess its efficiency and progressiveness. In its report published in 1940, the Commission criticized taxes on consumption because of their cumulative effect and their regressivity. It recommended eliminating the federal sales tax remitted by manufacturers. Implementing these recommendations proved impossible, however, because of the additional financial needs of Canada's war effort from 1939 to 1945.

The provinces also faced growing budget constraints. As early as the 1920s they taxed gasoline, and after 1939, all but Nova Scotia and New Brunswick were collecting personal income tax. Retail sales tax was first introduced by Montreal in 1935, at a rate of 2%. Alberta was the first province to levy retail sales tax, from 1936 to 1937, but Saskatchewan bears the distinction of being the first to impose sales tax permanently in 1937, followed by Quebec in 1940, British Columbia in 1948, New Brunswick and Newfoundland in 1950, Nova Scotia in 1959, Prince Edward Island in 1960, Ontario in 1961 and Manitoba in 1967.

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(2) J.S. Mill's distinction is not valid. Direct taxation supposes that the tax is paid by the person targeted. Anyone familiar with tax shifting, however, knows that several forms of direct taxation ultimately fall on other parties.

B. The Federal Government's Unlimited Powers

The Quebec Government lost no time in denouncing the federal government's decision regarding GST, calling it unconstitutional. It maintained that such a tax would be flagrant interference in an area of taxation reserved for the provinces, and obtained a legal opinion that the federal government was exceeding its constitutional powers. Quebec was alone, however, in playing the constitutional card in its fight against the federal decision. In the final communiqué from their Quebec meeting, the provincial premiers spoke more moderately of interference in a traditionally provincial jurisdiction.

Nevertheless, the interpretation of subsection 91(3) of the Constitution Act, 1867, gives the federal government unlimited powers of taxation. Since the Constitution provides no legal constraint in this area, federal authorities can use any methods of taxation, even if they duplicate those of the provinces. Thus the provinces can hardly cite constitutional arguments.

In 1966, the Royal Commission on Taxation (Carter Commission) recommended imposing a retail sales tax jointly with the provinces (thus a form of NST), to replace the federal sales tax applied to manufacturers. The provinces were to be responsible for collecting this tax. The Commission considered "there was merit in the provinces taking prime responsibility for one of the major revenue sources" and recommended:

> that the federal government should try to negotiate a transfer of sales tax room to the provinces in exchange for more federal direct tax room.(3)

During the NST negotiations from 1987 to 1989, however there is nothing to show that Ottawa was prepared to offer the provinces such a compromise as regards taxation powers in order to gain more acceptance for its plan. On the contrary, there is every reason to believe the federal authorities took a hard line during the negotiations and perhaps did not really try to conclude an agreement. In fact, it was learned from a confidential provincial source that the provinces were surprised when

(3) Royal Commission on Taxation, Report, Volume V, Queen's Printer, Ottawa, 1966, p. 6.

talks were broken off on 24 April 1989, for the negotiations were supposed to resume after the federal budget was tabled. Did Ottawa feel compelled to act in this way because of time constraints? Examples from abroad make it clear that the process of introducing such a tax is lengthy and complex. In view of loss of revenue and the electoral cost, the Minister probably felt he could no longer afford to delay before announcing the proposed new tax.

At their meeting in Quebec in August 1989, the provincial premiers agreed that negotiations with Ottawa should resume with a view to introducing a new and improved tax.

POLITICAL ARGUMENTS

The gist of the provinces' political arguments is that they would lose autonomy and flexibility as a result of the proposal. A report prepared for the New Brunswick Government in 1987[4] recommended rejecting any agreement with the federal authorities regarding an NST because of the uncertainty of the provinces' sales tax revenue and the loss of their flexibility and control in setting fiscal policy.

A study written for the Ontario Government used a similar argument:

> For Ontario, an important factor is the degree of autonomy the province would lose within the framework of a joint sales tax. At the very least, once a province gave its agreement it would no longer be able to alter the list of tax-exempt goods and services without the agreement of all the other participating governments.[5]

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(4) Donald Breon, Neil Bruce, et al., Review of the New Brunswick Tax System, Volume II: An Assessment of New Brunswick's Tax System and Recommendations for Reform, Institute for Research on Public Policy, June 1987.

(5) Anne Anderson, Sales Tax Reform: An Overview from Ontario. Current Issue Paper No. 90, Ontario Legislative Research Service, February 1989, p. 22.

Though these arguments helped to turn the provinces against an NST, it is now realized that provincial autonomy would be curtailed in any event, with or without an agreement. The provinces' present freedom to set the rate and base of their retail sales taxes would be greatly reduced if Ottawa were also collecting a 9% multi-stage tax on consumption.

As we read in the April 1989 budget,(6) the federal government hopes to raise $17.2 billion in 1989-90 from the present federal sales tax and over $18.3 billion in 1990-91. The revenue that would be raised by the 9% multi-stage sales tax as early as 1991 is estimated at $24 billion.(7) As for the provinces, their retail sales taxes brought in over $16.5 billion in 1988-89 (see Table 1). Surely there must be limits to what two governments can collect by taxing consumption.

The provincial governments' loss of room to manoeuvre in fiscal matters is probably the only indisputable argument they have with which to oppose the introduction of a federal tax on consumption. There can be no war of statistics on this front. This restriction on legislative power would be particularly tight for provinces that do not themselves administer corporate and personal income tax. We can expect, however, that this argument will not be well received in Ottawa, for cooperative federalism goes only so far.

FISCAL ARGUMENTS

The effects of a federal multi-stage sales tax on the financial situation of the provinces remain to be determined. They would be felt in four areas: on provincial sales tax revenue, on provincial direct taxation revenue, on federal-provincial funding and fiscal agreements and on provincial expenditures.

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(6) Department of Finance, Budget Papers, Ottawa, 27 April 1989, p. 7.

(7) It is quite possible that Canada, like most of the countries that tax consumption by means of a multi-stage tax, would increase its rate in the near future. VATs are commonly called "milch cows." In the Canadian context, each percentage point increase would give $2.6 billion to the federal government; thus there would be a strong temptation to increase the rate of the tax.

FEDERAL SALES TAX AND PROVINCIAL RETAIL SALES TAX REVENUE, 1979-80 TO 1990-91

31 MARCH OF EACH YEAR
MILLIONS OF DOLLARS

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989(e)	1990(e)	1991(e)
CANADA	4,651.0	5,355.0	6,148.0	5,842.0	6,561.0	7,592.0	9,345.0	11,972.0	12,927.0	15,820.0	17,200.0	18,320.0
Newfoundland	212.4	237.9	250.4	264.9	318.1	334.7	359.6	406.1	444.0	477.3		
Prince Edward Island	26.9	35.2	40.2	44.0	52.8	57.0	61.5	63.6	72.5	80.0		
Nova Scotia	192.1	204.1	215.5	285.1	341.8	395.6	444.8	476.9	524.6	570.3		
New Brunswick	187.3	192.2	205.4	221.3	313.8	354.3	408.8	446.2	485.0	531.9		
Quebec	1,592.7	1,665.1	1,714.9	1,865.3	2,194.5	2,488.1	3,082.6	3,533.7	3,900.0	4,247.6		
Ontario	2,436.6	2,590.8	2,882.9	3,455.0	3,917.3	4,470.1	5,073.5	5,654.5	6,353.0	7,866.0		
Manitoba	227.2	243.2	269.0	272.2	362.0	397.2	442.7	469.2	590.0	596.0		
Saskatchewan	250.1	304.7	321.1	316.5	344.5	349.9	379.7	361.1	467.3	481.4		
Alberta									15.0	22.0	23.0	
British Columbia	640.9	738.3	1,141.5	1,010.1	1,213.7	1,347.9	1,473.9	1,564.9	1,472.0	1,669.3		
PROVINCIAL TOTAL	5,766.2	6,211.5	7,040.9	7,734.4	9,058.5	10,194.8	11,727.1	12,976.2	14,323.4	16,541.8		

(e): Estimated

SOURCE: Statistics Canada

A. Effects on Provincial Sales Tax Revenue

The proposed federal sales tax would affect the provinces' indirect tax revenue. The extent would depend on the new definition of the tax base, the effective federal sales tax rate and the elasticity of the demand for taxable goods and services.

1. Tax Base

The federal plan provides for a very broad tax base that would, however, exclude medical equipment, prescription drugs and basic groceries. The planned changes in the federal tax base would tend to increase or decrease the amount of provincial revenue. The narrower the provincial base in comparison to Ottawa's, the less the proposed tax would be likely to influence provincial retail sales tax revenue. Thus it is clear that for goods and services not taxed provincially, such as furniture in Quebec, provincial revenue would not be affected.

The provincial retail sales tax base includes federal sales tax, where applicable. Consequently, provincial tax is calculated, for certain goods and services, on a retail sales price that includes federal tax. The provincial revenue from retail sales would necessarily be lower if the tax base did not include the multi-stage federal tax, but we do not know exactly what would happen if it did.

Certain goods or services are now subject to provincial tax[8] and excluded from the federal tax base (in Manitoba, for example, labour costs for repairs and temporary lodging services). It is easy to see that if Ottawa were to use a new base including the goods and services now included in the provincial tax bases, provincial government revenue from those goods and services could increase. At the same time, the demand for goods and services taxed by both levels of government could decrease, because of the increase in after-tax prices, and this would slightly reduce the increase in provincial revenue. Alberta has no provincial sales tax.

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(8) For a comparison of provincial tax bases, see A.J. Robinson, The Retail Sales Tax in Canada, Canadian Tax Paper 77, Canadian Tax Foundation, Toronto, 1986; and Manitoba Department of Finance, Provincial Sales Tax Comparison, 20 April 1988, 58 p.

Since 1 June 1987, however, a 5% tax has been applied to the rental of motel or hotel rooms. Clearly, if Ottawa imposed a 9% tax on the value added offered by the hotel, the provincial tax base would increase by that amount: the effective provincial tax rate would be 5.45% and revenue would increase. If the demand was not sensitive to the price increase, this hidden provincial tax rate would translate into additional revenue of over $2 million in 1989-90.

For goods and services already subject to federal and provincial tax, the effects of the proposed federal tax on revenue are unclear. We must therefore look at the effective tax rate and the elasticity of the demand for taxable goods and services.

2. Effective Tax Rate

The effective sales tax rate is the percentage of the final sales price of a product which represents tax. Under the present system, this is difficult to calculate. On the one hand, manufacturing input sold to manufacturers is taxed, and part of this tax is passed on to consumers. On the other hand, if there are several middlemen before the retailer (manufacturers, distribution firms and wholesalers), and if competition is strong, the federal sales tax burden may not be passed on proportionately to the consumer. This is especially true if profit margins are higher, as with luxury goods.(9) Conversely, if there are few or no middlemen, as in the automotive or telecommunications industries, the federal sales tax is all passed on to the consumer. The June 1987 White Paper on tax reform included a table showing that the effective federal tax rate on goods subject to 12% tax averaged out to 7.26% (see Table 2 for a modification of these data to take into account the increase in this tax to 13.5%).

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(9) Let us suppose that a manufacturer, a wholesaler and a retailer have 20% profit margins and federal sales tax is 13.5%. A product worth $100 is sold to the wholesaler at a cost of $113.50, resold to the retailer for 147.55 and retailed to the consumer for $191.82. The effective tax rate is 7% (in other words, $13.5/$191.82). It is easy to see that the greater the profit margin, the lower the ratio of federal tax to retail price.

Table 2

EFFECTIVE FEDERAL TAX RATE ON A SAMPLE OF DOMESTIC GOODS

	Average rate (%)
Commodities with 13.5% statutory rate	
Luggage, purses and wallets	6.17
Blankets, bed sheets and towels	5.77
Carpets, rugs and mats	8.43
Household textiles	7.08
Household furniture	7.54
Small appliances	10.16
Kitchen utensils	6.91
Household air cleaning machinery	8.36
Household appliances	9.10
Hand tools	5.82
Power tools	8.57
Builder's hardware	9.11
Brooms and brushes	7.08
Smokers' accessories	5.07
Glassware and glass products	6.13
Garbage bags, paper plates	10.47
TV, radios, stereos	9.39
Electric light bulbs, lamps	5.88
Office furniture	10.35
Office and stationery supplies	6.66
Office machines and equipment	12.60
Household cleaning components	8.75
Tires	9.35
Auto parts	6.65
Recreation vehicles	9.70
Batteries	5.88
Lubricating oil and grease	9.02
Canoes, sail boats	11.64
Watches and clocks	7.08
Photographic equipment	10.91
Jewellery	5.28
Sporting equipment	8.49
Toys and game sets	9.61
Cosmetics	8.72
Paint, varnish, wallpaper	10.21

N.B. The effective sales tax rate is the percentage of a commodity's final selling price represented by tax. The figures in this table are derived from those published in the White Paper entitled "Tax Reform 1987: Sales Tax Reform" (Table 2.2, p. 17). To reflect the rise in the statutory rate from 12 to 13.5%, the original figures were multiplied by 1.125. For the group of commodities "Paint, varnish, wallpaper," the effective rate published in 1987 was multiplied by 1.6875.

Under the new multi-stage indirect taxation system, the entire burden of the sales tax would be borne by the final consumer. The effective tax rate would thus be 8.26% (or, for goods worth $100, $9/$109). Consequently, if the effective tax rate on a product is at present higher than 8.26%, the provinces would suffer a decrease in tax revenue on that product, since the retail sales price would decrease. This would be the case for alcohol, tobacco products, telecommunications services and automotive vehicles. In this last case, the real tax rate is probably close to 11.9% (or 13.5/113.5), and it is reasonable to believe that the tax burden is almost entirely passed on to the consumer. Conversely, if the effective tax is at present lower than 8.26%, as is the case with goods such as jewellery that have a large profit margin, the provinces should see their revenue increase To take another example, automotive parts are now taxed at 13.5%, for an average effective rate of 6.65%. As prices increase, provincial revenue from them should also rise.

3. Elasticity of the Demand for Taxable Goods and Services

In order to assess the impact of the proposed tax on provincial revenue, we must also know the elasticity of the demand for taxable goods and services. If consumers were particularly responsive to variations in price, the demand for goods and services subject to lower federal taxes could increase more than the absolute decrease in taxes, which would increase provincial revenue. Conversely, the decrease in the demand for goods and services subject to higher taxes could be greater, in absolute terms, than the tax increase, which would translate into a decrease in provincial revenue. Finally, if the demand was not responsive to the tax increase, provincial revenue would vary according to price fluctuations after the tax was introduced.

The federal government intends, for example, to tax lottery tickets, gambling and pari-mutuel betting. In the case of provincial lotteries, if consumers are very sensitive to increases in ticket prices, we could expect a significant drop in demand, which would reduce revenues for lottery corporations and racetracks, and consequently the provinces. There are alternatives to raising ticket prices. Corporations could reduce

their payments to provincial governments by absorbing the entire cost of the tax. This decision would cause the greatest decrease in revenue: Loto-Quebec has estimated it at $40 to $50 million. Lottery officials have two other choices: reduce the prize money paid to winners or reduce the probability of winning. The second solution is believed to be the best, because consumers are not sensitive to such subtle changes as a reduction in probability, and governments would thus minimize their losses.

4. Evaluation of Effects

Thus we see that the effects of the proposed GST on provincial revenue from taxes on consumption are difficult to assess. We need to know the tax base, the effective federal tax rate and the elasticity of demand in relation to prices before we can quantify them. The provinces must be especially careful when they argue that the goods and services tax would reduce their revenue, for its positive effects may well outweigh its negative impact.

On 9 August 1989, the day after the Technical Paper[10] was released, several commentators claimed that total provincial revenue would increase by $400 million thanks to the broader new base. Ontario Treasurer Robert Nixon estimated that his province would receive an additional $170 million from the tax on consumption.

B. Effects on Direct Taxation

In order to help middle-income taxpayers, the August 1989 Technical Paper announced that the middle marginal income tax rate would be reduced from 26 to 25% in 1991. This reduction over the whole country would cost the federal government $700 million. One quarter of this would be the loss from Quebec, which administers its own provincial income tax. In the other nine provinces, provincial income tax (administered for them by the federal government) is set at 55% of federal income tax. Thus these provinces would stand to lose some $289 million, by the 1% reduction.

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(10) Department of Finance, Goods and Services Tax: Technical Paper, August 1989.

C. Effects on Federal-Provincial Agreements

Within the framework of established funding programs, the federal government intends to raise the amounts paid to the provinces. The formula used to calculate the amount of transfers takes into consideration the provincial gross domestic product (GDP) and population size. Since the government forecasts that the proposed tax would in the longer term cause a 1.4% increase in the provincial GDP, the provinces could receive more money from the federal authorities, in fact $300 million more (in 1991 dollars). This could only happen, however, after all the gains from the GST materialized. According to the government's best hypothesis, by 1994 the GDP would only have increased by 0.7%. Consequently, the provinces would have access to only a fraction of the promised amounts.

Section 125 of the Constitution Act, 1867 gives the federal and provincial governments reciprocal exemption from sales tax. Despite this constitutional protection, six provinces (Quebec, Ontario and the Atlantic Provinces) agreed with the federal government in 1977 to introduce a fiscal reciprocity system, which British Columbia and Manitoba joined in 1983. Under this system, the provinces do not claim the federal sales tax refund they are entitled to, and Ottawa does the same for sales tax levied by the provinces. According to the government, these agreements do not lead to any appreciable transfer of funds between the two levels of government. This fiscal reciprocity system would terminate when the GST came into effect.

Reciprocity now favours some provinces, for they pay out less in federal taxes than Ottawa does in provincial taxes. In 1988, the province of Quebec had a positive balance of some $22 million because of this system (the amount is probably lower now, since the basic federal sales tax rate has since risen from 12 to 13.5%). These provinces stand to lose from the negotiations regarding the new rules applicable to the two levels of government.

D. Effects on Provincial Expenditures

1. Purchases by Public Sector Agencies

The greater part of purchases by certain public sector agencies (hospitals, municipalities, libraries, schools, colleges and universities) would be exempt from the proposed tax; in other words, tax would not be applied at the final stage in the purchasing process. These agencies would thus receive a partial refund of the sales tax payable on their inputs.

The government plans to establish four average refund percentages, one for hospitals, one for municipalities, one for schools and one for colleges and universities. If the partial sales tax exemption was not sufficient to prevent the sales tax reform from increasing their tax burden, operating costs for some of these agencies could rise. It is easy to see that if an agency consumes goods and services that are taxed higher than the average rate, the adjustment factor for refund purposes would not meet the amount of federal tax actually paid.

These agencies could also tend to meet their own needs as far as possible in order to avoid the burden of the GST. For example, we could see municipalities repairing their own roads instead of calling in private firms. These agencies might need financial assistance, which could increase the expenditure burden on provincial governments.

2. Inflation

The federal government maintains that the proposed sales tax would cause a one-time increase of 2.25% in the Consumer Price Index (CPI). As many payments made by the provinces are indexed to the cost of living (such as social assistance and public sector employees' pension plan benefits), it is predictable that provincial expenditures in this area would increase.

The provincial share of cost-shared general assistance program payments, for example, totalled $3.26 billion as at 31 March 1988.(11) If we assume that social assistance transfers would be indexed

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(11) Data provided by the Program Finance Division, Canada Assistance Plan Directorate, Health and Welfare Canada.

to variations in the CPI, provincial expenditures would increase by $73.3 million (in 1988 dollars).

CONCLUSION: GST OR NST?

The provinces are faced with a fait accompli: Ottawa plans to introduce unilaterally a multi-stage 9% tax. The provinces make many arguments against this measure. As we have seen, the constitutional arguments are groundless. The political arguments and regional concerns have some merit, but we can expect very few people to be aware of them. As for the fiscal arguments, and in particular the impact of the GST on indirect taxation revenue, the provinces would first have to prove that the adverse effects of the tax outweighed its positive ones (unless federal tax was excluded from retail sales prices, in which case provincial criticism would clearly be justified). The loss in revenue caused by the reduction in the middle marginal income tax rate from 26 to 25% would be very costly for every province except Quebec. Some provinces could lose the slight advantage afforded them by the fiscal reciprocity agreement they have with Ottawa. The effect on the amounts transferred to the provinces within the framework of established funding programs still remains to be determined, and much is unclear at present about the impact of the GST on provincial expenditures. We do know that the indexing of the allowances paid out by the provinces could be expensive. The provinces' fiscal balance is thus difficult to evaluate.

Perhaps the provinces will ultimately decide to participate in an NST. The main advantages of such a shared tax would be a significant reduction in administration and compliance costs and increased economic effectiveness because there would be fewer distortions. During the hearings held by the House of Commons Finance Committee on 15 August 1989, the government stated that with an NST, the GDP would increase by more than 2%, compared to the 1.4% predicted under the system now proposed.

There are also disadvantages to provincial participation, however. It is difficult to estimate in advance what revenue the provinces could derive from a national VAT. The taxation of goods and services not

at present taxed by the federal government would have effects on consumer habits and economic activity that are difficult to evaluate. Broadening the federal tax base under an NST system would have different effects on each of the provincial bases, with the heaviest impact on those provinces with the narrowest bases, such as Quebec.

Moreover, a common tax base applied all across the country would substantially reduce provincial governments' room to manoeuvre in indirect taxation. Once the NST was in place, the provinces would probably have very little influence on defining the tax base. The only choice left to them would be to raise or lower their respective rates. This loss of autonomy in setting tax policy would be especially noticeable in provinces that do not administer their own corporate and personal income tax. Furthermore, as we have seen, provincial autonomy would be eroded even if the provinces did not participate in an NST. If we assume that there are limits to what two governments can obtain by taxing consumption, the provinces' freedom to act in fiscal matters would certainly be greatly eroded under the federal goods and services tax system.

The other problem with an NST is that the provinces would have to bear the full weight of resentment towards a tax of between 9 and 18%, depending on the province, for this tax would be imposed and administered by the provinces. Alberta, for example, would have everything to lose, while Ottawa would shift the blame by giving the provinces the burden of administering the tax. It is only surprising that Ottawa has not relied more on this strategy and pushed harder in negotiations with the provinces. With a tax like this the federal government would not stand to lose anything in political terms.

We can thus say that the provinces may perhaps be well advised at present not to participate in federal plans for an NST. Once the proposed federal tax was implemented, they would be better placed to estimate the revenue that it would generate. Moreover, they could observe the workings of a VAT closely and so better evaluate its economic and administrative consequences and distributive effects.

Even more important for the provinces, their refusal to participate in an NST leaves the federal government on its own to carry

the political and electoral burden of sales tax reform. The provinces can only congratulate themselves on what they have done. The debate now taking shape could be long and carry a very high political price, and Ottawa will have to go alone against formidable opposition.

APPENDIX

Sections of the Constitution Act, 1867 governing taxation powers

- 91. It shall be lawful for the Queen, by and with the Advice and Consent of the Senate and House of Commons, to make Laws for the Peace, Order, and good Government of Canada, in relation to all Matters not coming within the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces; and for greater Certainty, but not so as to restrict the Generality of the foregoing Terms of this Section, it is hereby declared that (notwithstanding anything in this Act) the exclusive Legislative Authority of the Parliament of Canada extends to all Matters coming within the Classes of Subjects next herein-after enumerated; that is to say, - [...]

  3. The raising of Money by any Mode or System of Taxation. [...]

- 92. In each Province the Legislature may exclusively make Laws in relation to Matters coming within the Classes of Subjects next herein-after enumerated; that is to say, - [...]

  2. Direct taxation within the Province in order to the raising of a Revenue for Provincial Purposes. [...]

  9. Shop, Saloon, Tavern, Auctioneer, and other Licences in order to the raising of a Revenue for Provincial, Local, or Municipal Purposes. [...]

- 121. All Articles of the Growth, Produce, or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces.

- 122. The Customs and Excise Laws of each Province shall, subject to the Provisions of this Act, continue in force until altered by the Parliament of Canada.

- 123. Where Customs Duties are, at the Union, leviable on any Goods, Wares, or Merchandises in any Two Provinces, those Goods, Wares, and Merchandises may, from and after the Union, be imported from one of those Provinces into the other of them on Proof of Payment of the Customs Duty leviable thereon in the Province of Exportation, and on Payment of such further Amount (if any) of Customs Duty as is leviable thereon in the Province of Importation.

- 124. Nothing in this Act shall affect the Right of New Brunswick to levy the Lumber Dues provided in Chapter Fifteen of Title Three of the Revised Statutes of New Brunswick, or in any Act amending that Act before or after the Union, and not increasing the Amount of such Dues; but the Lumber of any of the Provinces rather than New Brunswick shall not be subject to such Dues.

- 125. No Lands or Property belonging to Canada or any Province shall be liable to taxation.